

Message Text

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ACTION EB-07

INFO OCT-01 EUR-12 ISO-00 SP-02 AID-05 NSC-05 CIEP-01

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C O N F I D E N T I A L ATHENS 7192

DEPARTMENT PASS TREASURY

E.O. 11652: GDS

TAGS: EFIN, GR

SUBJECT: DRACHMA, DOLLAR, AND SNAKE

1. GOVERNOR OF BANK OF GREECE XENOPHON ZOLOTAS, IN CONVERSATION WITH ECONOMIC COUNSELOR, NOTED CONFIDENTIALLY THAT GREECE THIS SUMMER HAD COMPLETELY REMOVED THE DOLLAR FROM THE MARKET-BASKET OF CURRENCIES BASED UPON WHICH THE BANK OF GREECE DAILY SETS THE DRACHMA BUYING/SELLING RATES. IN EFFECT, THIS MEANS THAT THE DRACHMA HAS IN RECENT WEEKS BEEN LINKED TO THE EC-SNAKE, SO THAT THE NEARLY FULL IMPACT OF THE DOLLAR'S RECENT APPRECIATION COULD BE REFLECTED IN THE DRACHMA-DOLLAR RATE. THIS HAS CONTRIBUTED TO A 14 PERCENT DEVALUATION OF THE DRACHMA VIS-A-VIS THE DOLLAR, FROM 30 TO THE DOLLAR IN MARCH TO 34.12 THIS WEEK. ZOLOTAS BELIEVES THAT THIS EXCHANGE RATE MOVEMENT HAS ALREADY HAD A FAVORABLE IMPACT ON GREECE'S BALANCE OF PAYMENTS (JANUARY-AUGUST EXPORTS WERE UP 20 PERCENT OVER THE CORRESPONDING PERIOD OF LAST YEAR, WHILE IMPORTS WERE UP ONLY 8 PERCENT). ZOLOTAS EXPRESSED SATISFACTION WITH THIS NEW BANK OF GREECE
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EXCHANGE RATE POLICY AND HINTED THAT HE MIGHT PERMIT A

SLIGHT DEVALUATION OF THE DRACHMA AGAINST THE SNAKE CURRENCIES
IN COMING WEEKS.

2. COMMENT: THE CARAMANLIS GOVERNMENT INHERITED A CLEARLY
OVERVALUED DRACHMA, AND WE BELIEVE THAT THE BANK OF GREECE'S
EXCHANGE RATE POLICY IN RECENT MONTHS REVEALS A COMMENDABLE
RECOGNITION OF GREECE'S BALANCE OF PAYMENTS REALITIES.
ZOLOTAS, AS HE MADE CLEAR IN HIS IMF SPEECH THIS MONTH, IS
OPPOSED TO A SYSTEM OF FREELY FLUCTUATING EXCHANGE RATES AND
HE PUSHED FOR ADOPTION OF THE PRESENT GREEK SYSTEM AS A BUFFER
AGAINST THE SOMETIMES WILD gyrations OF THE INTERNATIONAL
CURRENCY MARKETS, IN WHICH THE DRACHMA HAD BEEN CAUGHT BY
VIRTUE OF ITS LINK TO THE DOLLAR. BY SEVERING THE DRACHMA-
DOLLAR LINK, GREECE GAINED GREATER FLEXIBILITY FOR ITS
DOMESTIC POLICIES, FOR EXAMPLE, IF THE DRACHMA HAD MOVED UP
ALONG WITH THE DOLLAR THIS SUMMER VIS-A-VIS THE DEUTSCHE
MARK, FRENCH FRANC, ETC., GREEK CREDIT POLICY WOULD, BECAUSE
OF THE ADDITIONAL NECESSITY UNDER THESE CIRCUMSTANCES
TO RESTRAIN IMPORT DEMAND, PROBABLY HAVE HAD TO BE TIGHTER
THAN IT WAS IN ACTUALITY, WITH RESULTANT ADVERSE IMPLICATIONS
FOR DOMESTIC ECONOMIC RECOVERY.

3. BREAKING THE DOLLAR LINK IN MARCH--WHEN THE DOLLAR HAD
NO PLACE TO GO BUT UP--WAS A PARTICULARLY ASTUTE MOVE TO
AVOID AN APPRECIATION OF THE DRACHMA VIS-A-VIS THE CURRENCIES
ACCOUNTING FOR THE PREPONDERANT SHARE OF GREECE'S TRADE,
AND TO SET IN TRAIN A GRADUALIST DEVALUING CRAWL OF THE
DRACHMA. HOWEVER, THIS CAN ONLY BE REGARDED AS A FIRST STEP.
WE QUESTION, FOR EXAMPLE, WHETHER THIS POLICY COULD REALLY
HAVE HAD A SIGNIFICANT IMPACT ON THE BALANCE OF PAYMENTS YET,
GIVEN NORMAL LEADS AND LAGS--ESPECIALLY SINCE ONLY ABOUT 20
PERCENT OF GREECE'S FOREIGN TRADE IS TRANSACTED IN DOLLARS.
IN EFFECT, THE DRACHMA STILL REMAINS LINKED WITH CURRENCIES
ACCOUNTING FOR FOUR FIFTHS OF ITS PAYMENTS. THIS ALSO
EXPLAINS WHY THE DRACHMA/DOLLAR DEVALUATION HAS NOT ADDED
TO DOMESTIC INFLATIONARY PRESSURES (THE WHOLESALE PRICE
INDEX ROSE BY ONLY 2.5 PERCENT BETWEEN JANUARY AND AUGUST,
CONSUMER PRICES BY 5.6 PERCENT IN THE SAME PERIOD). THE
REAL TEST WILL COME AS THE DRACHMA BEGINS TO DIVERGE FROM
THE SNAKE CURRENCIES, WHICH WOULD PARALLEL--AND TO SOME
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EXTENT OFFSET--THE FURTHER GRADUAL REMOVAL OF TRADE
BARRIERS VIS-A-VIS THE EUROPEAN COMMUNITY.

4. FROM THE U.S. POINT OF VIEW, IT IS TOO EARLY TO TELL
WHETHER THE CHANGE IN DOLLAR/DRACHMA PARITY WILL SIGNIFICANTLY
AFFECT U.S. EXPORTS TO GREECE, BUT SOME ADVERSE EFFECT IS
A POSSIBILITY.
KUBISCH

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